

EDiv-AG-1.03 On page 22, the witness states, "It is my view that more frequent procurements -- even if only to assemble the same portfolio -- would likely be less risky than the Company's proposal. The administrative costs of acquiring the portfolio through more than one process -- whether more than one annual auction or otherwise -- may be greater, but these amounts will be very small in relation to both the overall costs of the portfolio and to the risks that might be mitigated by doing so." Assuming that the Commission approves the concept of holding more than one auction in order to acquire supply for one or more periods beginning January 2007: (a) How many auctions would be appropriate? (b) When (provide a month and year) should each of the auctions be held? (c) Given your answer to (a) and (b), what is your estimate of the increase in administrative costs due to holding more than one auction? (d) Please quantify the reduction in risk associated with your proposal.

Mr. Salgo's Response:

- (a) Over the course of a year, prices may vary dramatically, so more frequent purchases throughout the year would help to mitigate risk, as compared with making a single large purchase at the "wrong" time. That is, more frequent purchases will reduce the potential variance. Increasing the frequency of purchases from one time per year would help mitigate timing risk, but this should be balanced with making purchases so frequently that additional administrative costs do not offset the benefits.

I have not made an assessment of the proper number of auctions (if, as posited by the question, an auction could or would be approved by the Commission), but my sense is that 4-6 (every two to three months) might be reasonable.

- (b) See answer to (a) above. I do not have a specific date for each auction.
- (c) See the answers to (a) and (b) above. I do not have a cost estimate. The Company is presumably in a position to know if the web-based auction process, once initiated and utilized, has significant incremental costs due to increased frequency. Obviously, the cost of employing an auction administrator during each procurement would have to be incurred.

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- (d) If the problem is envisioned as a sampling-type of problem, an increased number of samples should reduce the risks associated with drawing a poor outcome (a high price) in a single auction. In other words, the variance around the expected value would be reduced. I have not quantified the reduction in risk resulting from this change.